IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re JOEL LEE FRAZIER Debtor.	No. 01-20744 Chapter 7
G. WAYNE WALLS, Trustee, Plaintiff, vs. SAM FRANCIS, Defendant.	Adv. Pro. No. 02-2007

M E M O R A N D U M

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

This 11 U.S.C. § 547 preference action is before the court on the parties' cross motions for summary judgment. Without conceding the remaining elements of a preference, the defendant Sam Francis asserts that the chapter 7 trustee will be unable to establish "an antecedent debt." In the alternative, the defendant contends that the transfer in question is excepted from avoidance under § 547(c)(1) of the Bankruptcy Code as a contemporaneous exchange for new value or that the doctrine of recoupment is a defense. For the reasons discussed below, the court concludes that all of the elements of a preference have been established and that no defenses raised by the defendant in his motion for summary judgment preclude avoidance. Accordingly, the court will grant the trustee's motion for partial summary judgment and deny the defendant's motion. This is a core proceeding. *See* 28 U.S.C. § 157(b)(2)(F).

I.

The debtor filed for chapter 7 bankruptcy relief on March 6, 2001. In the complaint commencing this adversary proceeding, the chapter 7 trustee alleges that on December 28, 2000, within the ninety days preceding the bankruptcy filing, the defendant received a payment from the debtor by check no. 6029 in the

amount of $9,100, which check was honored by the bank on January 4, 2001. The trustee contends that this transfer meets all of the requirements for a preference under § 547(b).

The "rest of the story" is set forth in the defendant's affidavit filed in support of his motion for summary judgment on August 1, 2002. Mr. Francis states in his affidavit that he is in the manufacturing business and that in order to move his manufacturing operations to Sullivan County, Tennessee, he entered into an agreement with the debtor Joel Frazier d/b/a Timberline Construction on August 22, 2000, for the construction of a manufacturing facility. A copy of the agreement attached to Mr. Francis' affidavit sets forth the specifications for a "Pre-engineered All Steel Building" to be constructed for a price of $215,000 and provides "[p]ayment to be made as follows: 15% upon signature of contract, 50% upon delivery of building materials, balance on completion." Mr. Francis indicates in his affidavit that he paid the debtor $32,650[1] on August 22, 2000, the day the agreement was signed, and that on October 20, 2000, the day after the prefabricated steel building was delivered to the construction site, he paid the debtor $107,500. According

[1]It is unclear why $32,650 was the amount of the first payment since the contract provided for payment of 15% when the contract was signed and fifteen percent of $215,000 is $32,250 rather than $32,650.

to Mr. Francis, he and the debtor had agreed that the project was to be completed by December 15, 2000, but upon visiting the site in December 2000, he learned that "no work had been performed toward erection of the steel" and that "the 2 wings which were to house the compressor room and 'mud' room respectively had not been ordered with the building, as originally specified." During a conversation between the debtor and Mr. Francis on December 27, 2000, they agreed to modify the specifications for the building by eliminating the building's wings and, in turn, the debtor agreed to return $9,100 to Mr. Francis. This is the $9,100 transfer from the debtor to Mr. Francis on December 28, 2000, which the chapter 7 trustee seeks to avoid and recover in this adversary proceeding.

In his motion for summary judgment filed July 22, 2002, supported by his affidavit, the trustee alleges that this transfer meets all of the elements of a preference under § 547(b) and, therefore, he is entitled to partial summary judgment in his favor. In response, the defendant filed his own summary judgment motion on August 1, 2002, based on the alleged lack of an antecedent debt, the contemporaneous exchange exception, and the doctrine of recoupment. Both parties have also filed replies to the other's summary judgment motion.

II.

Fed. R. Civ. P. 56, as incorporated by Fed. R. Bankr. P. 7056, mandates the entry of summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." In ruling on a motion for summary judgment, the inference to be drawn from the underlying facts contained in the record must be viewed in a light most favorable to the party opposing the motion. *See Schilling v. Jackson Oil Co. (In re Transport Assocs., Inc.)*, 171 B.R. 232, 234 (Bankr. W.D. Ky. 1994)(citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242 (1986)). *See also Street v. J.C. Bradford & Co.*, 886 F.2d 1472 (6th Cir. 1989).

III.

"To qualify as a voidable preference [under 11 U.S.C. § 547(b)], a transfer must '(1) benefit a creditor; (2) be on account of antecedent debt; (3) be made while the debtor was insolvent; (4) be made within 90 days before bankruptcy; and (5) enable the creditor to receive a larger share of the estate than if the transfer had not been made.'" *Luper v. Columbia Gas of Ohio, Inc. (In re Carled, Inc.)*, 91 F.3d 811, 813 (6th Cir.

1996)(quoting *Union Bank v. Wolas*, 502 U.S. 151 (1991)). Most of these requirements are established by the defendant's answer and the affidavit of the chapter 7 trustee. As noted in the trustee's memorandum of law, the defendant admits in his answer that the transfer was for his benefit and that he received a check from the debtor for $9,100 within the ninety days prior to March 6, 2001, the date on which the debtor commenced the underlying bankruptcy case. The trustee states in his affidavit that claims filed in the debtor's chapter 7 case total more than $600,000, that to date he has received only $19,414.53 for the benefit of the estate, and, therefore, unsecured claims will not be paid in full. This recitation satisfies the element that the transfer enabled the creditor to receive a larger share of the estate than if the transfer had not been made. *See Still v. Rossville Bank (In re Chattanooga Wholesale Antiques, Inc.)*, 930 F.2d 458, 465 (6th Cir. 1991)("Unless the estate is sufficient to provide a 100% distribution, any unsecured creditor ... who receives a payment during the preference period is in a position to receive more than it would have received under a Chapter 7 liquidation.... Thus, the 'more than' requirement of the statute is satisfied ...."). And, the insolvency element is satisfied by the presumption created by § 547(f) of the Bankruptcy Code since the defendant has not proffered any

evidence to rebut the presumption. *See Akers v. Koubourlis (In re Koubourlis*), 869 F.2d 1319, 1322 (9th Cir. 1989).

The only remaining required elements necessary to establish that the $9,100 transfer was a preference is that the defendant must be a creditor of the debtor and the transfer must have been on account of an antecedent debt. Although neither admitted in the answer nor set forth in the trustee's affidavit, it does appear that the defendant is a creditor. Section 101 of the Bankruptcy Code broadly defines "creditor" as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." 11 U.S.C. § 101(10)(A). Mr. Francis has filed a proof of claim in this case in the amount of $140,150 for "Monies paid for Construction of Commercial Building" and references in an attachment the monies he paid the debtor on August 22 and October 20, 2000. As such, there appears little dispute that Mr. Francis is a creditor, notwithstanding the absence of an express concession in this regard.

With respect to the "antecedent debt" requirement, the Bankruptcy Code does not specifically define this term, but the treatise COLLIER ON BANKRUPTCY observes that as a general rule, a debt is antecedent if it is incurred before or preceded the transfer. 5 COLLIER ON BANKRUPTCY ¶ 547.03[4] (15th ed. rev. 2002). The

defendant contends in support of his summary judgment motion that the payment in question was not made on account of an antecedent debt because "on the date of the transfer, there was no debt owed Francis by Frazier." "Frazier's return of the funds was simply the refund of an advance payment to which Frazier agreed he was not entitled." In support of this contention, the defendant cites *In re Riverside Supply, Inc.* wherein the court held that "the return of the advance payment on a canceled contract is not considered a preference." *Walsh v. Cobaugh (In re Riverside Supply, Inc.*), 58 B.R. 661, 663 (W.D. Penn. 1986).

After careful consideration of the issue, this court must disagree with the defendant's assertion that no debt was owed by the debtor to the defendant when the $9,100 payment was made. The Bankruptcy Code defines a "debt" as a "liability on a claim." 11 U.S.C. § 101(12). "This definition reveals Congress' intent that the meanings of 'debt' and 'claim' be coextensive." *Pa. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 558 (1990). "Claim" is defined by the Code as a:

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable

> remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5). In the *Davenport* decision, the United States Supreme Court noted that the legislative history to this definition described it as the "broadest possible" and encompassing "all legal obligations of the debtor." *Davenport*, 495 U.S. at 558 (quoting H.R. REP. NO. 95-595, at 309 (1977), *reprinted in* 1978 U.S.C.C.A.N., at 6266).

When the debtor executed the contract in August 2000 agreeing to construct a prefabricated steel building, he clearly incurred a legal obligation to the defendant. If the debtor failed to fulfill the contract, the defendant would have a cause of action under Tennessee law for breach of contract which would entitle him to recover from the debtor. *See Oakwood Furniture Mfg., Inc. v. Ruh & Pressley Const. Co.,* 1993 WL 477020, *4 (Tenn. App. 1993)("As a general rule, the measure of damages for defects and omissions in the performance of a construction contract is the reasonable cost of the repairs."). Of course, at that point, the defendant's right to payment was contingent on the debtor breaching the agreement. However, even a contingent right to payment is a claim of the defendant and coextensively a debt on the part of the debtor.

Furthermore, the defendant's right to payment from the debtor lost its contingent nature when the debtor breached the contract by failing to order the "2 wings" as originally agreed upon by the debtor and defendant. The parties resolved this breach by the defendant agreeing to release the debtor from that aspect of the contract in exchange for a return of a portion of the purchase price. In the case of *In re Bob Grissett Golf Shoppes, Inc.*, the debtor entered into an agreement with the defendant in December 1981 for the purchase of certain golfing equipment. *Bob Grissett Golf Shoppes, Inc. v. Confidence Golf Co. (In re Bob Grissett Golf Shoppes, Inc.)*, 44 B.R. 156, 157-59 (Bankr. E.D. Va. 1984). When the debtor failed to pay, the defendant sued the debtor in state court and the parties thereafter settled the dispute by the debtor agreeing to pay the defendant the sum of $19,000 in four installments. *Id.* After paying the first installment, the debtor filed for bankruptcy relief and a complaint was filed to recover the installment as a preference under § 547. The defendant argued in that case that the payment did not meet the antecedent debt requirement because the debt was not incurred until the settlement was reached. *Id.* The court rejected this contention, concluding that the debt was incurred in December 1981 upon the making of the contract. As stated by the court:

> It is well settled that a debt is incurred on the date the debtor becomes obligated to pay. [Citation omitted.] Clearly, an obligation to perform arises upon the making of a binding contract....
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> ....
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> ... A contract which is clear and unambiguous in its terms on which the parties have agreed governs the relationship between the parties.... A later compromise of a claim is of no effect as to when the debt arose.

Id. at 158-59. *See also Upstairs Gallery, Inc. v. Macklowe West Dev. Co. (In re Upstairs Gallery, Inc.),* 167 B.R. 915, 918 (B.A.P. 9th Cir. 1994)(later compromise of claim does not affect the time when the debt first arose for preferential transfer purposes)*; Durant's Rental Center, Inc. v. United Truck Leasing, Inc. (In re Durant's Rental Center, Inc.)*, 116 B.R. 362 (Bankr. D. Conn. 1990) (payments made in settlement of debtor's lease obligations were on account of antecedent debt which was incurred when lease payments became due rather than at time of settlement). Thus, it is clear that the transfer at issue in this action was "on account of an antecedent debt."

To the extent this conclusion is contrary to the result in the *Riverside Supply* decision cited by the defendant, then this court must respectfully disagree with that court although it appears that certain aspects of that case render it distinguishable from the facts herein. In *Riverside Supply*, the

debtor prepetition entered into a contractual relationship with the defendant whereby the debtor agreed to order various home building supplies on the defendant's behalf. *In re Riverside Supply, Inc.*, 58 B.R. at 661-62. The defendant gave the debtor $2,014 as an advance payment, but the debtor failed to perform and thereafter refused to refund the payment. The defendant filed suit and after receiving a judgment, collected the amount owed from the debtor. Subsequently, the debtor filed for bankruptcy relief and the trustee sued to avoid the transfer of the collected amount as a preference. Characterizing the defendant's original payment to the debtor as a "deposit" in "the nature of a trust to guarantee payment" rather than a loan, the court concluded that the requirement of an antecedent debt was not met, noting that the parties had intended the supplies to be shipped contemporaneously with the debtor's receipt of them. *Id*. at 662.

In the present case, by contrast, there is nothing in the agreement signed by the parties which would indicate that the payments by the defendant to the debtor were deposits or somehow in the nature of a trust to guarantee payment.[2] Nor does the

[2]The defendant states in his affidavit that by the time of the refund to him on December 27, 2000, the debtor had not performed sufficient work or provided sufficient materials to (continued...)

agreement in the present case intimate in any way that the parties' obligations thereunder are conditional, unlike the conclusion reached by the court in *Riverside Supply*. Furthermore, this court is puzzled by that court's observation that the payment therein was not a loan since a debt may be incurred even though no loan has taken place.

A more analogous case to the facts herein is a case cited by the trustee, *Sigmon v. Royal Cake Co. (In re Cybermech, Inc.)*, 13 F.3d 818 (4th Cir. 1994), wherein the bankruptcy trustee sought to avoid and recover as a preference the debtor/seller's return of a buyer's down payment for the purchase of certain machinery. The court rejected the defendant's assertion that no antecedent debt existed at the time the down payment was returned, concluding that the original down payment by the buyer to the seller gave rise to a duty on

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[2](...continued)
have earned all of the money paid by him to the debtor. In support of this contention, the defendant attaches a worksheet as an exhibit to his affidavit, which he states establishes that the value of the work performed and materials supplied was far less than $139,650. According to the defendant, the difference between the actual value of the work and materials and the $139,650 amount constitutes an advance payment. However, the contract between the parties provides for payment in three specified stages, rather than on the basis of the value of the work performed. Because the payments were made by the defendant in accordance with the time frame set forth in the contract, they were not "advance" payments as the defendant claims.

the part of the seller to either produce the machinery or refund the down payment. Correspondingly, the payment gave the buyer the right to demand either performance or a refund and this right constituted a claim and thus a debt, notwithstanding its contingent nature. *Id.* at 821-822.[3]

Based on all of the foregoing, the court concludes that the $9,100 transfer to the defendant was on account of an antecedent debtor. Accordingly, all of the elements of a preferential transfer under § 547(b) have been met and the transfer is

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[3]The defendant argues in his reply brief that reliance on *Cybermech* is unwarranted because it was based in part on the court's conclusion that the seller/debtor would have had no obligation to refund the down payment in the event of the buyer's breach. The defendant states that this result would not be true in Tennessee because the seller would have to refund the down payment to the extent it exceeded his damages. The court in *Cybermech* did make this statement in a footnote, although it was made in addressing the defendant's argument that return of the down payment was not preferential because it never became property of the estate. *See In re Cybermech*, 13 F.3d at 820, n.2. The court rejected the assertion, noting that the down payment was not a deposit or property being held in trust by the seller which the seller would be required to return in the event the sale fell through, but money to which the seller was entitled and over which it had complete dominion and control. *Id*. at 820. There is nothing in the opinion which would indicate that a right to a refund in the event of the buyer's breach would have altered the court's conclusion that a debt was incurred at the time of the down payment. A buyer's counterclaim based on the assertion that the payments by the buyer exceeded the seller's damages does not obviate the fact that legal obligations constituting contingent claims arose upon the payment of the down payment in *Cybermech* and upon the execution of the contract in the present case.

avoidable unless the contemporaneous exchange exception of § 547(c)(1) applies or the doctrine of recoupment precludes recovery.

With respect to the contemporaneous exchange exception, 11 U.S.C. 547(c)(1) provides:

> (c) The trustee may not avoid under this section a transfer—
> (1) to the extent that such transfer was—
> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
> (B) in fact a substantially contemporaneous exchange.

Under this provision, "a transfer that would otherwise be considered preferential is insulated from attack by the trustee if (1) the preference defendant extended new value to the debtor, (2) both the defendant and the debtor intended the new value and reciprocal transfer by the debtor to be contemporaneous and (3) the exchange was in fact contemporaneous." 5 COLLIER ON BANKRUPTCY ¶ 547.04[1] (15th ed. rev. 2002).

The defendant observes that the purpose of the exception is to protect transactions that do not diminish the value of the estate, citing *Anderson-Smith Assocs., Inc. v. Xyplex, Inc. (Matter of Anderson-Smith & Assocs., Inc.)*, 188 B.R. 679 (Bankr. N.D. Ala. 1995). According to the defendant, the debtor's

bankruptcy estate was not diminished by the transfer because the debtor was relieved from purchasing and erecting the wings on the building.

As noted above, the first element of the contemporaneous exchange exception is that the "preference defendant extended new value to the debtor." The Bankruptcy Code defines "new value" in the preference context as:

> money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation.

11 U.S.C. § 547(a)(2).

The only new value given by the defendant was a release of the obligation to purchase and erect the two wings on the building. It has uniformly been held that the "[r]elease of or credit on a debtor's preexisting obligation does not qualify as 'new value' under 547(a)(2)." *Jones v. Ryder Integrated Logistics, Inc. (In re Jotan, Inc.*), 264 B.R. 735, 750 (Bankr. M.D. Fla. 2001). The Eleventh Circuit Court of Appeals has observed that a debtor's payment for release of or for credit on a contingent, antecedent obligation represents the very sort of transfer that § 547(b) was enacted to avoid. *Nordberg v. Arab*

Banking Corp. (In re Chase & Sanborn Corp.), 904 F.2d 588, 595-96 (11th Cir. 1990). "If 'new value' included credit toward such debts, thus rendering such transfers categorically *nonavoidable*, section 547 would be rendered a tautological nullity." *Id*. at 596 (emphasis in original). *See also In re Upstairs Gallery, Inc.,* 167 B.R. at 919 ("Creation and contemporaneous payment of a new debt in cancellation of an antecedent debt violates both the form and policy against preferences."). Because the defendant in this case did not give new value, the contemporaneous exchange exception of § 547(c)(1) is inapplicable.

The defendant's last line of defense is based on the doctrine of recoupment. The defendant states that he has an allowed claim in this bankruptcy case of over $140,000 and argues that in the event the $9,100 payment is a preference, he should be allowed to use the doctrine of recoupment to offset the amount he owes against the amount owed to him.

This argument has no merit. "Recoupment is 'the setting off against asserted liabilities of a counterclaim arising out of the same transaction.'" *Tri County Home Health Servs., Inc. v. United States Dep't of Health and Human Servs. (In re Tri County Home Health Servs., Inc.)*, 230 B.R. 106, 110 (Bankr. W.D. Tenn. 1999)(quoting *Reiter v. Cooper*, 507 U.S. 258, 264 (1993).

> There are two general requirements to characterizing a withholding as recoupment. First, some type of overpayment must have been made. [Citation omitted.] Second, both the creditors' claim and the amount owed to the debtor must arise from a single contract or transaction. [Citation omitted.] Recoupment is generally allowed in cases involving a single contract which called for advance payments based on estimates, subject to correction at a later time. [Citation omitted.]

Id. at 110-11.

In the present case, there has been no overpayment by the defendant as the trustee observes in his reply memorandum. The construction contract specified a total price of $215,000; the defendant only paid $140,150 of this amount. This was not a contract involving "advance payments based on estimates, subject to correction at a later time." Instead, the contract set a firm, established price and specified intervals over which this price was to be paid. Application of the doctrine of recoupment to the facts of this case would effectively eliminate preference recovery whenever the preference defendant has a claim against the estate arising out of the same transaction. This is not the law as codified in the Bankruptcy Code.

IV.

An order will be entered contemporaneously with the filing of this memorandum opinion granting the trustee's motion for partial summary judgment and denying the defendant's motion.

FILED: August 26, 2002

BY THE COURT

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE